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DynCorp – Cerberus: Developments in Deal Protection

On April 12, 2010, DynCorp International, Inc., announced its purchase by Cerberus Capital Management, LP, in a transaction valued at $1.5 billion, which includes the assumption of debt. The DynCorp – Cerberus agreement contains a number of deal protection terms including a "go-shop" provision, breakup fees, matching rights, fiduciary termination rights and change of recommendation provisions. Certain of these terms are worth examining in light of prevailing market terms and recent Delaware decisions in the deal protection context, including Cerberus' own abandoned acquisition of United Rentals, Inc.

Go-Shop Provision

Under the terms of the DynCorp – Cerberus agreement, DynCorp may solicit alternative proposals from third parties in a go-shop period lasting for the 28-day period following the signing and may at any time consider alternative unsolicited proposals. Recent Delaware case law regarding go-shop provisions, primarily in private equity deals, addressed go-shop periods of varied length, but which in each case featured a provision providing for a two-tiered breakup fee. In general, an alternative proposal entered into during the go-shop period triggered a lower termination fee than an alternative proposal entered into after the go-shop period. The cases, *In re Lear Shareholder Litig.*,926 A.2d 94 (Del. Ch. 2007); *In re Topps Co. Shareholder Litig.*, 926 A.2d 58 (Del. Ch. 2007); and *Berg v. Ellison,* C.A. No. 2949-VCS (Del. Ch. June 12, 2007), focused on (i) the length of the go-shop period and (ii) the trigger for the payment of the lower breakup fee. The lower breakup fee could be triggered if the alternative proposal was received during the go-shop period whether or not signed during or after such period, or the trigger could require that the seller actually execute the alternative proposal within the go-shop period. In *Berg*, the court suggested strongly that 25 days was too short a go-shop period. In comparison, in *Lear*, a 45-day go-shop period was deemed too short, if the alternative proposal had to actually sign within that time, because in the court's view that time period was not sufficient to permit all the diligence, negotiation, drafting and other work to be completed. If the provision only required the alternative proposal to be made within the 45-day go-shop period, that was likely to be viewed as an acceptable time period.
The DynCorp – Cerberus go-shop clause is relatively short when viewed in the context of these recent court decisions; however, the agreement attempts to ameliorate the abbreviated time period by omitting the two-tiered fee structure, permitting DynCorp to consider alternative unsolicited proposals at any time, without the threat of an increased termination fee.

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Termination Fee

Under the terms of the DynCorp – Cerberus agreement, in the event of a termination in connection with an alternative proposal or material breach of the agreement, DynCorp would be obligated to pay a termination fee of $30 million, which is 2 percent of the $1.5 billion transaction valuation. DynCorp would additionally be liable for up to $12 million in transaction costs if the termination was due to a failure to receive stockholder approval in the presence of an alternative proposal. This termination fee is on the lower end of the typical termination fee range, particularly in light of recent transactions that have seen termination fees creeping toward the 4 percent range.[1]

Reverse Termination Fee

If DynCorp terminates the agreement due to Cerberus' material breach of the agreement, Cerberus would be obligated to pay a reverse termination fee of $100 million, or approximately 6.7 percent of the $1.5 billion transaction valuation. This 6.7 percent reverse termination fee represents a significant multiple of DynCorp's termination fee. It is also significant when juxtaposed against the $100 million, or little more than 1 percent, reverse termination fee Cerberus paid to get out of its proposed $4 billion buyout of United Rentals. This continues a trend in which the size of reverse termination fees has been decoupled from the size of the corresponding termination fees. Recent examples of this trend include the Merck – Schering-Plough and Pfizer – Wyeth transactions. In each case, the reverse termination fee was approximately 6 percent of the transaction value, substantially in line with the size of the reverse termination fee in the DynCorp – Cerberus deal.

Of additional interest to lawyers drafting and negotiating these provisions is the articulation of the termination and remedies provisions in the DynCorp – Cerberus agreement, particularly (i) Section 8.5(g), which, "notwithstanding anything to the contrary" explicitly limits the remedies available to either party *in the event of a termination* of the agreement for "any losses or damages suffered as a result of any breach of any representation, warranty, covenant or agreement" to the relevant termination fee, and upon payment of that fee such party "shall have no further liability or obligation relating to or arising out of" the agreement; and (ii) Section 9.5(c) regarding the availability of specific performance and the agreement of each party "not to raise any objections to the availability of the equitable remedy of specific performance." The attention paid to these provisions is not surprising in light of the litigation surrounding Cerberus' abandoned acquisition of United Rentals. United Rentals sued Cerberus when it pulled out of the deal unilaterally. The court denied United Rentals' request for specific performance, ruling that the merger agreement between buyer and seller was ambiguous regarding the remedy of specific performance, as sought by the buyer, and allowed Cerberus to walk away from the deal (subject to the payment of the $100 million reverse termination fee) based on the "forthright negotiator principle." The court looked to negotiations between the parties along with the contract language itself, and concluded that United Rentals officials should have known that Cerberus executives believed they had a right to pull out of the deal at any time as long as they paid the $100 million reverse termination fee. See *United Rentals, Inc. v. Ram Holdings, Inc.*, 937 A.2d 810, 813 (Del Ch. 2007). This ambiguity has been addressed in the DynCorp – Cerberus agreement in favor of a clear right to specific performance.

Termination for Willful Breach

If either party to the DynCorp – Cerberus agreement "willfully breaches" the agreement prior to its termination date, that party shall pay the other $300 million, equal to 20 percent of the $1.5 billion transaction valuation. "Willful breach" is defined as a material breach of any representation, warranty, covenant or other agreement set forth in the agreement that is a consequence of an act or failure to act by the other party with the actual knowledge that the taking of such act or failure to act would cause a breach. It is notable that this provision attempts to address Delaware Chancery Court Vice Chancellor Stephen Lamb's opinion in *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, C.A. No. 3841 (VCL) (Del. Ch. Sept. 29, 2008) regarding the determination as to whether a party has committed a "knowing and intentional" breach of a merger agreement. Vice Chancellor Lamb rejected the buyer's argument that a party must "have actual knowledge that such actions breach the covenant" and have acted (or not acted) "with the conscious object of breaching" the agreement.[2] The DynCorp – Cerberus agreement specifically requires the "actual knowledge" that the action or inaction would cause a breach of the agreement that Vice Chancellor Lamb found lacking in a more generally drafted "knowing and intentional" provision. Thus, the standard for payment of the $300 million fee is a very high standard indeed.

Conclusions

The DynCorp – Cerberus agreement reflects the unique and specific nature of deal protection negotiation as well as the conflicting trends borne out of an extraordinarily difficult financing atmosphere and a period of very weak seller leverage. Recent reports have shown a trend toward bigger reverse breakup fees in public company transactions, in order to avoid being "left at the altar."[3] The reverse breakup fee found in the DynCorp – Cerberus agreement reflects this trend coming out of the breakup of a number of transactions based on difficult market conditions. In any event, deal protection terms should be viewed as a whole, and not in terms of whether any individual term is "market." Care must be taken to balance a buyer's desire for deal certainty with the requirement that the deal protection terms be reasonable and protective of a seller board's fiduciary responsibilities.

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[1] Around 3 percent is the average for reverse termination fees. Post-Crisis, the Evolving Structure of Deals, posting of Steven M. Davidoff to DealBook Blog, http://dealbook.blogs.nytimes.com/ (Mar. 30, 2010).

[2] *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, C.A. No. 3841 (VCL) (Del. Ch. Sept. 29, 2008) Op. at 57-59.

[3] Anthony Curry et al., Turning a Corner at Citigroup, N.Y. Times, Apr. 20, 2010, at B2.

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